

TENNESSEE GENERAL ASSEMBLY
FISCAL REVIEW COMMITTEE



FISCAL NOTE

SB 80 - HB 70

February 24, 2015

SUMMARY OF BILL: Makes changes to the *Revised Tennessee Captive Insurance Act*. Authorizes the Commissioner of Commerce and Insurance to approve a rating service plan submitted by a licensed captive insurance company for the purpose of providing workers' compensation coverage. Authorizes the commissioner to waive certain self-insurance requirements of captives offering workers' compensation coverage. Requires any pure captive, industrial captive, protected cell captive, incorporated cell captive or special purpose financial captive insurance company to file a statement of investment policy with the commissioner which details the types of investments that the company may elect to undertake, and subsequently may not deviate from such policy. Requires each captive entity, regardless of mutual ownership, to pay premium taxes separately, rather than collectively. Creates a new fee for a change in ownership of a captive entity at \$400 for a protected cell captive insurance company (PCIC) and \$125 for a protected cell. Authorizes captive entities to pay its surplus requirements through a cash equivalent. Authorizes the commissioner to use premium tax revenue collected by insurance companies to promote the Tennessee captive insurance industry.

ESTIMATED FISCAL IMPACT:

Increase State Revenue - \$101,000/FY15-16

\$182,700/FY16-17

\$286,200/ FY17-18

Exceeds \$286,200/FY18-19 and Subsequent Years

Increase State Expenditures - \$108,100/FY15-16

\$104,900/FY16-17 and Subsequent Years

Revenue recognition in the amount of \$100,000 and expenditures in the amount of \$122,900 (\$120,700 recurring and \$2,200 one-time) are included in the Governor's FY15-16 budget for this legislation.

Assumptions:

- Based on information provided by the Department of Commerce and Insurance's (DCI's) Captive Insurance Section (CIS), as of December 31, 2013, there were approximately 20 licensed PCICs and 8 cell companies. As of December 31, 2014, there were approximately 72 licensed PCICs and 202 licensed cell companies.

- In FY15-16, CIS estimates that this legislation will attract five (5) new PCIC's, each having an average of seven (7) captive cells for a total of 40 new captive entities $[5 + (5 \times 7)]$ that will require licensure.
- It is reasonably assumed that in FY16-17 and FY17-18, this legislation will result in five (5) additional PCICs annually, each having an average of seven (7) captive cells for a total number of 40 new captive entities each fiscal year.

Revenue

- Each PCIC and each captive cell is required to file an application with CIS and pay an application fee of \$675, for annual application fee revenue of \$27,000 in FY15-16, FY16-17, and FY17-18 ($40 \times \$675$).
- Changes in ownership of captives are not uncommon within the captive industry, as PCICs and captive cells are sold or transferred to third-party entities for various financially advantageous purposes.
- This legislation creates fees for change in ownership. Based on information provided by CIS, PCICs will pay \$400 and cells will pay \$125 for a change in ownership.
- CIS estimates that five percent (0.05) of all PCICs and licensed cell companies will annually experience a change in ownership.
- In FY15-16, five percent of the existing captive entities (72 PCICs and 202 cells) experiencing a change in ownership will result in fee revenue of \$2,850 $[(72 \times 0.05) \times \$400 + (202 \times 0.05) \times \$125]$.
- In FY16-17, five percent of the existing captive entities (77 PCICs and 237 cells) experiencing a change in ownership will result in fee revenue of \$3,100 $[(77 \times 0.05) \times \$400 + (237 \times 0.05) \times \$125]$.
- In FY17-18, five percent of the existing captive entities (82 PCICs and 272 cells) experiencing a change in ownership will result in fee revenue of \$3,350 $[(82 \times 0.05) \times \$400 + (272 \times 0.05) \times \$125]$.
- In the first year, the average gross premium collection of each parent cell or PCIC is estimated to be \$3,550,000. Total new premiums collected by these five (5) PCIC is estimated to be \$17,750,000 ($5 \times \$3,550,000$).
- Based on information provided by the Captive Insurance Section, the average premium tax collections growth rate in the first year is 14.9 percent (0.149). The 2nd and 3rd year compound annual growth rate for premium tax collections is 45.5 percent (0.455) and 72.1 percent (0.721), respectively. This percentage takes into account reinsurance premium tax collections. Reinsurance is a popular option for captives as it allows, among other financial benefits, the parent company of a PCIC to lower the amount of capital required to self-insure, subsequently releasing capital for other financing, investing, and operating activities. Reinsurance premiums, as applicable to current state law, are taxed at a lower rate.
- The annual gross premium tax is 4 percent (0.04) on the first \$20,000,000 premiums collected and 3 percent (0.03) on all premiums collected over \$20,000,000. It is reasonably assumed that not one of these five (5) new PCICs will collect total premiums surpassing \$20,000,000 in any of the first three (3) years upon creation.
- Premium tax collections in FY15-16 are estimated to be \$71,000 ($\$17,750,000 \times .004$)
- Premium tax collections in FY16-17 are estimated to be \$152,579 $\{[(\$17,750,000 \times 1.149) \times .004] + (\$17,750,000 \times .004)\}$.

- Premium tax collections in FY17-18 and recurring years exceeding \$255,884 $\{[(\$17,750,000 \times 1.455) \times .004] + [(\$17,750,000 \times 1.149) \times .004] + (\$17,750,000 \times .004)\}$.
- Pursuant to Tenn. Code Ann. § 56-13-114, this state, or any county, city or municipality is prohibited from levying any tax on captive entities in addition to this gross premium tax.
- Authorizing the CIS to use premium tax revenue to promote the Tennessee captives industry will likely result in increased state expenditures; however, any increase in expenditures is assumed to be offset by an increase in premium tax revenue collected from existing and new entrants to the Tennessee captive industry.
- The total increase in revenue in FY15-16 is estimated to be \$100,850 (\$27,000 + \$2,850 + \$71,000).
- The total increase in revenue in FY16-17 is estimated to be \$182,679 (\$27,000 + \$3,100 + \$152,579).
- The total increase in revenue in FY17-18 is estimated to be \$286,234 (\$27,000 + \$3,350 + \$255,884).
- It is estimated that revenues will continue to grow, resulting in increased revenues exceeding \$286,234 in FY18-19 and subsequent years.

Expenditures

- DCI intends to hire one Insurance Examiner - CPA position to assist the Captive Insurance Section in licensing and regulating captive insurance companies.
- This position will result in recurring costs of \$104,944 [salary \$76,800 + benefits \$17,869+ FICA \$5,875 (\$76,800 x 7.65 %) + office lease \$2,200 + phone \$1,000 + network \$600 + supplies \$600) and one-time costs of \$3,200 (Computer \$1,200 + Office Furniture \$2,000].
- There will be one-time expenditures of \$3,200 in FY15-16.
- There will be recurring expenditures of \$104,944 in FY15-16 and subsequent years.

IMPACT TO COMMERCE:

Increase Business Revenue - Exceeds \$17,700,000/Recurring

Increase Business Expenditures – Less Than \$17,700,000/Recurring

Commerce Impact - Recurring business expenditures will be reduced as a result of lower premium tax rates made available through self-insurance. Any such recurring reduction in business expenditures would be offset by other one-time increases in business expenditures for the cost incurred by businesses in relocating to Tennessee. The net reduction in business expenditures for businesses impacted by the bill is unknown, but is reasonably estimated to exceed \$100,000 per year. Any net impact to business revenue cannot be quantified because such impact is dependent upon multiple unknown factors.

Jobs Impact - The net impact to Tennessee jobs is difficult to determine because some companies may relocate to Tennessee as a result of this bill and

some jobs may transfer within Tennessee from one sector of the insurance industry to another. The net impact of Tennessee jobs is not quantifiable, but is considered positive.

Assumptions:

- The new PCICs are estimated to collect premium revenue in an amount that exceeds \$17,700,000 statewide. Any business expenditures are estimated to be less than the amount of revenue collected for the companies to remain solvent.
- Impacted businesses may benefit as a result of having reduced premium payments. Due to numerous unknown factors, any reduction to current business expenditures is unable to be determined. For companies that transfer employees from out-of-state, any decrease in expenditures attributable to reduced premium payments will be partially offset by new business expenditures incurred for the cost of relocating to Tennessee. It is assumed that the impacted businesses would not relocate to Tennessee if the cost of relocating exceeded the expenditure reductions from paying lower premium tax rates.
- Any net impact to business revenue, and thus net income for businesses, cannot be determined because such impacts are dependent upon multiple unknown factors such as the service rate charges applicable to insurance plans offered by newly created PCICs, the extent of competition that would exist currently from other Tennessee-domiciled businesses, and the extent that a market entrant would dilute market share for any particular industry.
- Authorizing the Captive Insurance Section to approve service rate plans offered by captives providing workers' compensation coverage is assumed to reduce business expenditures; as such companies would not offer a change to existing rates that would increase any percentage of or the total amount of payouts on claims by workers injured on the job.
- Secondary impacts to jobs may include increased consulting fees to licensed attorneys, CPAs and other professions within the state. Due to multiple unknown factors, this impact is unable to be determined, but is considered positive.

CERTIFICATION:

The information contained herein is true and correct to the best of my knowledge.



Jeffrey L. Spalding, Executive Director

/jdb